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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-400

FELIX BENITEZ REXACH, ET AL., *Petitioners*

v.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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The Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix B, *infra,* pp. 38a-75a) is not yet officially reported. It is unofficially reported at 73-2 USTC ¶ 9257 and 32 A.F.T.R. 2d 73-5338. The opinion of the United States District Court for the District of Puerto Rico (Appendix B, *infra,* pp. 2a-37a) is reported at 331 F. Supp. 524 (1971).

JURISDICTION

The judgment of the Court of Appeals (Appendix B, *infra,* p. 75a) was entered on June 27, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether respondent was collaterally estopped from asserting that the profit derived by petitioner[1] on construction contract payments received in 1959 and 1961 was other than 1/11th of the payments as previously determined in prior litigation involving the same contracts.

2. Whether in a tax collection suit the burden of proof shifted to the respondent once it was determined by the district court that the Commissioner's assessment was arbitrary.

3. Whether payments made by petitioner to the dictator of the Dominican Republic, General Trujillo, in 1959 were improperly disallowed as a deduction by the Commissioner under the "anti-kickback" provisions of Section 162(c) of the Internal Revenue Code of 1954, as amended.

STATUTES INVOLVED

The relevant provisions of the Internal Revenue Code of 1954 are set forth in Appendix A, *infra,* pp. 1a-2a.

STATEMENT

The instant suit, the third in a series of four suits brought by the respondent on behalf of the Internal Revenue Service against petitioner, was filed February

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[1] Felix Benitez Rexach will be hereinafter identified as the petitioner.

10, 1964, to foreclose liens for income tax, interest, and fraud penalties assessed against petitioner for the calendar years 1959 and 1961, in the total sum of $2,935,095.57, pursuant to Sections 7401-7403 of the Internal Revenue Code of 1954 and 28 U.S.C. 1340 and 1345. (R. 1, 26-33.)[2]

Petitioner was born in Puerto Rico on March 27, 1886, and became an American citizen under the provisions of what is commonly known as the Puerto Rico Organic Act of 1917 (48 U.S.C. Sec. 731 *et seq.*). (R. 1552.) Petitioner resided in Puerto Rico until 1934 when, upon the recommendation of him by the United States War Department to General Trujillo, petitioner went to Santo Domingo (then known as Ciudad Trujillo) where he undertook the construction of the harbor in Santo Domingo. (R. 346-355, 515-517, 950-957.) For a period of approximately 27 years, petitioner acted as chief harbor developer of the Dominican Republic, under the regime of the late dictator, General Trujillo. (R. 1553, 1565-1566.) From 1944 to 1962 petitioner was both a resident and domiciliary of the Dominican Republic. (R. 1553.)

For his taxable years beginning prior to 1951, petitioner, by virtue of his United States citizenship established under the Puerto Rico Organic Act of 1917, was treated for Federal income tax purposes as a non-resident alien and thus not subject to Federal income tax (except on income from United States sources) by virtue of Section 252(a) of the Internal Revenue Code of 1939. By the Revenue Act of 1950

[2] "R" reference are to the pages of the separately bound appendix in the court of appeals. "Ex. Vol." references are to the pages of the separate exhibit volumes in that court.

(64 Stat. 906, P.L. 814, 81st Cong., September 23, 1950), Section 252(a) of the Internal Revenue Code of 1939 was amended to provide that, for taxable years beginning after 1950, all citizens of Puerto Rico were subject to Federal income tax on all income except that derived from sources within Puerto Rico. (R. 1510.)

On March 29, 1954, in response to a request to petitioner's attorney, petitioner received an opinion letter from a Washington tax expert which advised petitioner that he was not subject to Federal income taxation on the income received from his construction contracts with the Dominican Republic.[3] (R. 1510.) Based on this opinion letter, which confirmed petitioner's belief that he was not subject to Federal income tax, petitioner filed no United States income tax returns for the years 1951 through 1956. (R. 548-549.)

On February 5, 1958, the Internal Revenue Service assessed against petitioner deficiencies in income tax, and fraud penalties, for the years 1951 through 1956 in the total amount of $2,354,478.48, and on March 3, 1958, the government filed suit (Civil No. 72-58) against petitioner in the United States District Court for the District of Puerto Rico to enforce collection of this assessment. (R. 1509-1510.)

The assessment made against petitioner with respect to the years 1951 through 1956 was based on the determination by the Commissioner of Internal Revenue that, on a percentage of completion basis, petitioner derived profits, or taxable income, in the amount of 1/11th (cost + ten percent profit) of the payments re-

[3] The text of this letter received by petitioner is set forth in a prior tax case of petitioner, *United States* v. *Rexach*, 185 F. Supp. 465, 471-472 (D. P.R., 1960).

ceived pursuant to petitioner's construction contracts with the Dominican government. (R. 1510.) Included within those construction contracts were (1) the contract signed on August 3, 1955, for the construction of port works in Boca Chica, and (2) the contract signed on April 19, 1956, for the construction of port works in Azua. (Ex. Vol. 182, 186, 290.)

On deposition petitioner had explained that in connection with his construction contracts he did not keep books and standard accounting systems as there were no accounting personnel available in the Dominican Republic, and further, that there was no need for keeping any accounting as the Dominican government did not compel a company to keep books of accounts. (R. 520.)

By way of stipulation signed by the parties and filed with the district court in Civil No. 72-58, the following facts were stated to be true and admissible in evidence:

> The defendant, Felix Benitez Rexach [petitioner herein], kept insufficient books and records during each of the years 1951 to 1956, or subsequent or prior thereto from which it could be adequately determined the amount of his gross income, deductible expenditures, or net income with respect to certain contracts here involved between the said Felix Benitez Rexach and the Government of the Dominican Republic. (Ex. Vol. 226-227.)

Further, it was stipulated that:

> The parties stipulate and agree that for the purposes of determining the net actual income per year, if any, of Felix Benitez Rexach for the years in question the percentage of profit and the estimated percentage of completion per year of each

> contract as determined by the Commissioner in accordance with his assessment [1/11th profit—percentage of completion formula] shall be applied and that no other basis, method or formula shall be used. (Ex. Vol. 229.)

On July 5, 1960, in Civil No. 72-58 (tax years 1951-1956) the district court found in favor of the government based on the 1/11th profit—percentage of completion formula stipulated to by the parties, whereby the government was entitled to recover $1,256,155.76 in tax plus interest, but held that the fraud penalties, as well as the alternatively assessed delinquency penalties, had been erroneously assessed against defendant. (R. 1511, Ex. Vol. 245-246, 248-249.) In its opinion,[4] the district court stated:

> For the purpose of determining the net taxable income of taxpayer for the years in question, the percentage of profit and the estimated percentage of completion per year for each contract as determined by the Commissioner in accordance with his assessment are to be applied and no other basis, method, or formula shall be used. (185 F. Supp. at 470.)

For his tax years 1957 and 1958, petitioner, on June 9, 1959, filed Federal income tax returns in which, by using the same 1/11th profit—percentage of completion formula, he included in his income as profits from his contracts with the Dominican government 1/11th of the contract payments allocable to those years. (R. 1511.) On June 22, 1959, the Internal Revenue Service assessed against petitioner deficiencies in income tax and fraud penalties for the year 1957 and partial

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[4] *United States* v. *Rexach*, 185 F. Supp. 465 (D. P.R., 1960).

year 1958 in the total amount of $306,363.30, and on February 26, 1960, the government filed suit (Civil No. 52-60) against petitioner to enforce collection thereof. (R. 1511-1512.)

In late May of 1961, petitioner paid $1,552,000.00 in taxes to the Dominican Republic for the years 1951 through 1958 and claimed a tax credit against his United States tax for those same years. (Appendix B, *infra*, p. 40a.) Upon a finding by the district court in Civil No. 52-60 that for the year 1957 the fraud penalty and alternative delinquency penalty had been erroneously assessed against petitioner (neither penalty had been asserted against petitioner for the partial year 1958)[5], this payment and the foreign tax credits it created resulted in the reduction of petitioner's tax liabilities to $76,866.01 for the years 1951 through 1956, and satisfied the government's claim for taxes for 1957 and 1958 (Ex. Vol. 248-249, 331.)

In order to obtain the construction contracts from the Dominican government, petitioner had to pay or obligate himself to pay to General Trujillo ⅓rd of the total contract prices; this practice was followed until the Yuna contract was awarded on public bidding to petitioner. (R. 1565-1566.) As found by the district court below, the government admitted that these payments of ⅓rd of the contract prices to the Dictator were ordinary business expenses in the Dominican Republic and were properly deductible from gross income as such under the Internal Revenue Code until the date on which the Technical Amendments Act of 1958 (P.L. 85-866, 72 Stat. 1606, 85th Cong., 2d Sess., September 2, 1958) became applicable. (R. 1566.)

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[5] *United States* v. *Rexach*, 200 F. Supp. 494, 497 (D. P.R., 1961).

At the time of the first suit, Civil No. 72-58 (tax years 1951-1956), counsel for petitioner informed government counsel that petitioner had made large payments to General Trujillo but was afraid to disclose the details thereof at trial. (R. 1017-1018.) The obligation of petitioner to make such payments to the Dictator on each of the contracts involved herein was incurred by petitioner at the time he obtained the contracts, which in each case was prior to September 2, 1958, the effective date of the Technical Amendments Act of 1958. At those times, as found by the district court the Dictator was not an official of the Dominican government, nor an employee of it; he was the Government. (R. 1556.)

With the advent of the first of the previous suits against petitioner, Trujillo was concerned that this practice would become public knowledge. Agents of the United States government were prohibited from inspection of petitioner's papers and records in the Dominican Republic and the projects petitioner had constructed or was constructing, although petitioner had consented to such examination provided that the Dominican government would permit it. It was the coercion of Trujillo that resulted in petitioner's denaturalization by the United States State Department on July 14, 1958, and only after Trujillo's assassination did petitioner institute proceedings in which the Board of Review on the Loss of Nationality of the U.S. Passport Office on June 25, 1962, held petitioner's denaturalization to be null and void. (R. 1566-1567.)

On April 9, 1961, petitioner entered into a contract with the Dominican Republic for the dredging of the Yuna and Barracote Rivers (hereinafter referred to as the Yuna contract) for a contract price of $4,700,-

000.00. (R.1561.) Petitioner's dredge had been towed to the work site in March of 1961, and his other equipment and personnel marshalled there and work started prior to May 1, 1961, whereupon the dredging operation was commenced. (R. 1324-1325.) On May 30, 1961, General Trujillo was assassinated, and petitioner's work on the Yuna contract was suspended by order of the Dominican government in June of 1961. Petitioner was paid $200,000.00 on account of the Yuna contract in 1961, and claimed a loss thereon for that year of $208,934.72. (R. 1565, 1571-1572.)

Also, in May of 1961, prior to Trujillo's assassination, petitioner received $1,552,000 in settlement of his claim for additional compensation on the Boca Chica contract. The Boca Chica contract, signed on August 3, 1955, contemplated the dredging of approximately 2,000,000 cubic yards of silt, sand and other soft material. (R. 1521-1522.) Instead of this type of material, rock was encountered, whereupon petitioner had filed a claim with the Dominican government for $3,750,-000.00 for compensation for the extra cost of dredging 1 million cubic yards of rock. (Appendix B, *infra*, pp. 53a-54a.) As found by the district court below, taking this $1,552,000 settlement into account, petitioner nonetheless sustained a loss on the Boca Chica contract. (R. 1573.)

On July 2, 1962, all of the Dominican properties of petitioner were seized by the Dominican government and put in the hands of a "sequestrator", or receiver. (R. 1554.) The seizure was made suddenly by Dominican soldiers who took over everything including petitioner's office and records and papers, and petitioner had to leave and thereafter had no access to his office. (R. 1554.) On July 6, 1962, following the nullification

of petitioner's denaturalization, petitioner filed an amended Federal income tax return for the entire year of 1958 and returns for the years 1959 through 1961. (R. 1555.)

On December 18, 1963, a jeopardy assessment was made against petitioner of an income tax deficiency plus interest thereon to the date of assessment, and a fraud penalty for each of the calendar years 1959 and 1961 as follows (Ex. Vol. 14-22):

	TAX	INTEREST	PENALTY	TOTAL
1959:	$ 384,803.99	$ 84,846.64	$192,401.99	$ 662,052.62
1961:	$1,419,589.30	$142,659.00	$709,794.65	$2,272,042.95
				$2,934,095.57

Thereafter, on February 10, 1964, the instant suit for collection (Civil No. 67-64) was filed (R. 1),[6] which suit was predicated, as pertinent herein, on the following assertions:

> (1) with respect to the $1,552,000.00 received by petitioner in settlement of his claim for additional expenses on the Boca Chica contract, the government was entitled to disregard the 1/11th profit-percentage of completion formula stipulated to and made a part of the previous decisions in Civil Nos. 72-58 and 52-60, and assert instead that the entire payment was profit to petitioner; (R. 1562-1564.)
>
> (2) with respect to the Azua and Ciudad Trujillo Customs House contracts, the govern-

[6] The fourth and final suit filed by the government against petitioner in 1965 to set aside the prior judgment in favor of petitioner in Civil Nos. 72-58 and 52-60 was dismissed by the district court on September 29, 1966. *United States* v. *Rexach*, 41 F.R.D. 180 (D. P.R. 1966).

ment was entitled to disregard the 1/11th profit-percentage of completion formula stipulated to and made a part of the previous decisions in Civil Nos. 72-58 and 52-60, and assert instead that petitioner had realized a 57½% profit on the contract payments allocable to 1959; (R. 1558-1559.)[7]

(3) with respect to the $200,000.00 payment received by petitioner as a part of the Yuna contract, the government was entitled to assert that 57½% was profit to petitioner, notwithstanding that the government never inspected the Yuna project nor that petitioner's records reflected a loss (after allowance for the $200,000.00 payment) of $208,934.72. (R. 1561-1562.)

In its Findings of Fact and Conclusions of Law filed September 20, 1971, the district court held as follows:

(1) There was no change in the circumstances or applicable law since the deficiency assessments covering the years 1951 to 1958 to justify a determination by the Commissioner that profits from the Azua and Customs House contracts in 1959 were 57½% of the contract prices instead of 1/11th thereof as previously determined by the

[7] The apparent basis for the government's assertion that petitioner derived a 57½% profit on the Azua and Customs House projects was an engineering report (Ex. Vol. 91-103) prepared for the government by an employee of the U.S. Army Corps of Engineers, Henry K. Armstrong, which stated that "[a]n overall general estimate, based on limited observations and investigations, is that the cost of harbor improvements built by [petitioner] will range from 40 to 45 percent of the contract payments." (Ex. Vol. 102.) This report was found by the district court to be not adequate or sufficient to show what petitioner's costs were on these projects. (Appendix B, *infra*, p. 22a.)

Commissioner, and in making such determination of 57½%, the Commissioner has not been consistent and is estopped from making such a change in determining the profits derived from these contracts. (R. 1582.)

(2) The determination by the Commissioner that the profits derived from the Azua and Customs House contracts in 1959 and from the Yuna contract in 1961 were 57½% of those portions of contract prices was arbitrary, unreasonable, incorrect and, with respect to the Azua and Customs House contracts, was based on a mistake of law, to wit, that petitioner was not entitled to deduct as costs the payments made to General Trujillo, the obligation to make such payments having occurred prior to September 2, 1958. (R. 1527-1528, 1582.)

(3) The disallowance by the Commissioner of the losses of petitioner on the Yuna contract in 1961 shown on petitioner's return to be not less than $208,934.72 was arbitrary and incorrect and was made without an examination of the work performed by petitioner under said contract in 1961, the cost thereof, and without examination of petitioner's records, and was based on erroneous assumptions of fact by the Commissioner. (R. 1583.)

(4) The Commissioner was in error in including in petitioner's income for 1961 as profits from the Boca Chica contract the amount of $1,552,000.00 received by petitioner in settlement of his claim for compensation for dredging rock since (1) petitioner had sustained a substantial

loss in the performance of these contracts and (2) profits had been determined on this contract in previous deficiency assessments on the basis of 1/11th of the contract price which had been accepted by both parties. (R. 1584.)

(5) The Commissioner failed to establish that petitioner had any purpose or intention to evade any tax and accordingly the fraud penalties were erroneously assessed against petitioner for each of the years 1959 and 1961. (R. 1586.)

In connection with the assessments of the Commissioner relating to the Customs House, Azua, and Yuna contracts, the district court held that although the burden of going forward with the evidence had been placed on petitioner by reason of the establishment of the deficiency assessment against petitioner, petitioner had met the burden of going forward, and as a result, the burden of proof shifted back to the Commissioner to prove the existence and amount of the deficiency, which burden the Commissioner had failed to sustain. (Appendix B, *infra,* pp. 24a-25a.)

On appeal, the court of appeals reversed the district court and held that:

(1) In a collection action, once proof of an assessment has been established, the burden of both going forward and ultimate pursuasion are always on the taxpayer and never shift to the Commissioner. (Appendix B, *infra,* pp. 43a-46a.)

(2) The Commissioner was not estopped from asserting that the profit derived by petitioner on the Azua and Customs House contracts was 57½% instead of 1/11th of the contract prices,

as not only was there a change of facts with respect to the year 1959 but also, with respect to the years 1951 through 1958, there had been no prior judgment on the merits that 1/11th of the contract prices was in fact profit. (Appendix B, *infra,* pp. 48a-49a.)

(3) The payments made to General Trujillo by petitioner with respect to the Azua and Customs House contracts (⅓rd of the contract prices) made after September 2, 1958, were barred by Section 5 of the Technical Amendments Act of 1958 (P.L. 85-866, 72 Stat. 1606, 85th Cong., 2nd Sess., September 2, 1958) which amended Section 162(c) of the Internal Revenue Code of 1954 to prohibit any deduction for payments made to an official or an employee of a foreign country after September 2, 1958, notwithstanding the fact that prior to this date petitioner had become obligated to make the payments in question. (Appendix B, *infra,* pp. 50a-52a.)

REASONS FOR GRANTING THE WRIT

A. THE HOLDING OF THE FIRST CIRCUIT THAT THE COMMISSIONER WAS NOT COLLATERALLY ESTOPPED FROM ASSERTING THAT THE PROFIT DERIVED BY PETITIONER ON CONSTRUCTION CONTRACT PAYMENTS WAS OTHER THAN 1/11th IS CONTRARY TO THE PRINCIPLES OF COLLATERAL ESTOPPEL ESTABLISHED BY THIS COURT AND IN CONFLICT WITH A DECISION OF THE COURT OF APPEALS FOR THE FOURTH CIRCUIT

For petitioner's tax years 1951-1956 and 1957-1958, the district court, in Civil Nos. 72-58 and 52-60, had found that, on a percentage of completion basis, petitioner had derived a profit on his construction contracts with the Dominican Republic of 1/11th of the

contract payments. The basis for this determination by the district court was a Stipulation of Fact submitted by the parties. In the proceedings below, the Commissioner had attempted to ignore this prior determination and asserted instead that petitioner had derived a 57½% profit on the Azua and Customs House contract payments received in 1959, and a 100% profit on the Boca Chica contract payment received in 1961. The district court below held that the Commissioner was estopped from asserting a higher profit, citing this Court's decision in *Tait* v. *Western Maryland Ry. Co.*, 289 U.S. 620 (1933). (Appendix B, *infra*, pp. 24a-25a.)

On appeal, the First Circuit reversed, holding that the Commissioner was not collaterally estopped as (1) there had been a change in the "controlling facts" within the meaning of *Commissioner* v. *Sunnen*, 333 U.S. 591 (1948), and (2) that there had been no prior judgment on the merits as required by *United States* v. *International Building Co.*, 345 U.S. 502 (1953). Petitioner submits that the First Circuit has improperly applied the principles of collateral estoppel established by this Court in both of these cases.

In the first place, the First Circuit's reliance on this Court's decision in *United States* v. *International Building Co., supra,* is totally misplaced. In *United States* v. *International Building Co., supra,* this Court held that the *stipulated dismissal* of a prior tax case did not constitute a determination for purposes of collateral estoppel in a subsequent tax case. As stated by the Court (345 U.S. at 505-506):

> . . . the decisions entered by the Tax Court . . . were only a pro forma acceptance by the Tax Court of an agreement between the parties to settle

> their controversy for reasons undisclosed .... As the case reaches us, we are unable to tell whether the agreement of the parties was based on the merits or on some collateral consideration....
>
> Estoppel by judgment includes matters in a second proceeding which were actually presented and determined in an earlier suit. 345 U.S. at 505-506.

By way of contrast, the prior proceedings (Civil No. 72-58) in the instant suit involved extensive stipulations of fact, evidentiary hearings, and briefs submitted by the parties, with an opinion, and findings of fact and conclusions of law entered by the district court. The 1/11th profit-percentage of completion formula which was used by the Commissioner as the basis for his assessment against petitioner was stipulated to by the parties, submitted to the district court, and, in turn, specifically adopted by that court in its judgment. This same 1/11th profit-percentage of completion formula was in like fashion incorporated in the later suit involving petitioner's tax years 1957 and 1958 (Civil No. 52-60). Clearly, there was a judgment *on the merits* in both these prior proceedings within the meaning of *United States* v. *International Building Co., supra.*

Moreover, the holding by the First Circuit that the stipulated 1/11th profit-percentage of completion formula was not a decision on the merits that such profit had in fact been realized for purposes of collateral estoppel is in conflict with the decision of the Court of Appeals for the Fourth Circuit in *Fairmont Aluminum Co.* v. *Commissioner,* 222 F. 2d 622 (1955), cert. denied 350 U.S. 838 (1955). In *Fairmont,* an excess profits tax case, taxpayer, in a prior proceeding before

the Tax Court, had attempted to establish the amount of its equity invested capital by way of a stipulation of fact submitted to court. The Tax Court held against the taxpayer on the ground that there had been a failure of proof. In a subsequent proceeding involving the same equity invested capital question as it affected a different tax year, the Tax Court held that the taxpayer was collaterally estopped to challenge its earlier decision. On appeal, the Fourth Circuit affirmed, stating (222 F.2d at 625):

> . . . There can be no question but that the [prior] judgment so rendered was a judgment on the merits and was binding upon the taxpayer on the principle of collateral estoppel on the issues raised as to its equity invested capital. A judgment on the merits is one which is based on legal rights as distinguished from mere matters of practice, procedure, jurisdiction or form. . . . *Certainly a judgment on an agreed statement of facts is a judgment on the merits, just as is a judgment on the pleadings.* (emphasis supplied.)

This holding of the Fourth Circuit is fully consistent with the decision of this Court in *Bissell* v. *Spring Valley Township,* 124 U.S. 225 (1888), that an admission of fact is as binding on the parties for purposes of collateral estoppel as is a fact independently found by the trier of fact.

Secondly, the First Circuit erred in holding that, with respect to the Azua and Customs House contract, new evidence was revealed so as to constitute a change in facts within the meaning of *Commissioner* v. *Sunnen, supra.* An examination of the record reveals that the only evidence relating to the Azua and Customs House contract was the engineering report pre-

pared by Henry K. Armstrong of the U.S. Army Corps of Engineers. (Ex. Vol. 91-103.) This report, in turn, reveals that no examination of any of the books and records incident to the construction contracts was made, no physical examination of the Customs House was made, and no detail was provided as to what an inspection "visit" to the Azua project (Ex. Vol. 96) revealed. As noted by the district court below, "[Armstrong's] report is not adequate or sufficient to show what the costs to [petitioner] of said projects were." (Appendix B *infra*, p. 22a.) There simply was no change in the "controlling facts" necessary to lift the bar of collateral estoppel.

The holding of the First Circuit that the Commissioner is not collaterally estopped from asserting that petitioner's profit was other than 1/11th of the contracts contravenes principles of collateral estoppel long established by this Court, and is in direct conflict with the decision of the Fourth Circuit in *Fairmont Aluminum*.

B. THE HOLDING OF THE FIRST CIRCUIT THAT IN A TAX COLLECTION SUIT THE BURDENS OF GOING FORWARD AND OF ULTIMATE PERSUASION ARE ALWAYS ON THE TAXPAYER IS IN CONFLICT WITH DECISIONS OF THE COURTS OF APPEAL FOR THE SECOND AND FIFTH CIRCUITS

In *United States* v. *Lease*, 346 F.2d 696 (1965) the Second Circuit stated that with respect to a collection action,

> . . . the Government has the burden of coming forward and persuading the trier that the taxpayer has or had a tax liability. If not challenged the assessment establishes that liability. A taxpayer's challenge must persuade the trier by a

> preponderance of the evidence that the assessment is erroneous. The Government then must still persuade the trier that on the basis of all the evidence there was a tax liability—perhaps in a different amount than initially asserted—for which the taxpayer was responsible. 346 F.2d at 701.

In a subsequent case adopting the reasoning of the Second Circuit in *Lease,* the Fifth Circuit, in *Bar L Ranch, Inc.* v. *Phinney,* 426 F.2d 995 (1970), adopted the conclusion of the Second Circuit, stating:

> . . . a taxpayer defending a collection suit need only show that the Government's assessment was arbitrary and . . . the burden is then on the Government to show whether any deficiency exists and, if so, in what amount. 426 F.2d at 999.

This reasoning is fully consistent with the principle established by this Court in *Helvering* v. *Taylor,* 293 U.S. 507 (1935), that where taxpayer has shown the Commissioner's determination to be arbitrary and excessive, the Commissioner's assessment will be held invalid in the absence of any further proof offered by the Commissioner.

In the instant case, the district court below held that the determination by the Commissioner that petitioner derived profits from the Customs House, Azua, and Yuna contracts in the amount of 57½% of the contract prices was arbitrary and unreasonable. (R. 1582.) Accordingly, the district court held that the burden of proof had shifted to the government to prove the existence and amount of the deficiency with respect to these contracts, and that on the evidence, the government failed to sustain its burden of proof as to the existence and amount of these items of the deficiency. (Appendix B, *infra,* p. 24a-25a.)

On appeal, the First Circuit reversed the district court on this point and held that in a collection action, the burden of proof never shifts to the Commissioner, a holding that is directly contrary to the decisions of the Second and Fifth Circuits. This conflict between the First Circuit and the Second and Fifth Circuits should be resolved by this Court on review to avoid a totally unwarranted disparity of treatment between equally situated taxpayers.

C. THE HOLDING OF THE FIRST CIRCUIT THAT PETITIONER'S PAYMENTS TO GENERAL TRUJILLO IN 1959, THE OBLIGATION TO MAKE SUCH PAYMENTS HAVING OCCURRED PRIOR TO SEPTEMBER 2, 1958, WERE BARRED BY THE "ANTI-KICKBACK" PROVISIONS OF SECTION 162(c) OF THE INTERNAL REVENUE CODE IS CONTRARY TO THE INTENT OF CONGRESS IN ENACTING THOSE PROVISIONS

Effective September 2, 1958, Congress enacted Section 5 of the Technical Amendments Act of 1958 (P.L. 85-866, 72 Stat. 1606, 85th Cong., 2nd Sess., September 2, 1958) which amended Section 162(c) of the Internal Revenue Code to prohibit the deduction for any payment to an official or an employee of a foreign country if the making of the payment would be unlawful under the laws of the United States. Prior to the enactment of this amendment, where the foreign government itself demanded or acquiesced in the payment, such payments were deductible under Section 162 as expenses ordinary and necessary to the taxpayer's business. (Senate Report No. 1983, 85th Cong., 2nd Sess., July 28, 1958, pp. 16, 124-125.) This is fully consistent with the principles established by this Court in *Commissioner* v. *Heininger,* 320 U.S. 467 (1943), *Lilly* v. *Commissioner,* 343 U.S. 90 (1952), and *Commissioner* v. *Sullivan,* 356 U.S. 27 (1958). In this regard, the dis-

trict court below noted that the government admitted that the payments by petitioner to Trujillo were ordinary business expenses in the Dominican Republic and properly deductible from gross income as such under Section 162 until the effective date of the Technical Amendments Act of 1958. (R. 1566.)

There can be no doubt that Congress specifically intended the application of this "anti-kickback" provision to be prospective not only in application, but in implication as well. To this end, Section 5(b) of the Technical Amendments Act of 1958 provided that:

> The amendment made by subsection 5(a) shall apply only with respect to expenses paid or incurred after the date of the enactment of this Act. The determination as to whether any expense paid or incurred on or before the date of enactment of this Act shall be allowed as a deduction shall be made as if this section had not been enacted and without inference drawn from the fact that this section is not made applicable with respect to expenses paid or incurred on or before the date of the enactment of this Act.

This provision is in turn consistent with the concern expressed by this Court in *Lilly* v. *Commissioner, supra,* that a legislative abolition of a particular practice, after notice being provided to all concerned, will result in the abolition of the practice without the retroactive hardship that is associated with completed transactions. 343 U.S. at 97-98.

As found by the district court below, the obligation of petitioner to make such payments to Trujillo was incurred by petitioner at the time he obtained the contracts, which in each case was prior to September 2, 1958. (Appendix B, *infra,* pp. 16a-18a. The obligation

to make these payments having been thus frozen prior to September 2, 1958, the subsequent disallowance of the deductibility of these payments by the First Circuit is clearly a retroactive application of the "anti-kickback" legislation, contrary to the express intent of Congress.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

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